Introduction

The US liberalisation of Cuban sanctions and recent reforms to the Cuban investment law have precipitated new foreign investment in Cuba. This article discusses the foreign investment law reforms, the Cuban prosecution of a Canadian investor as a cautionary sign, and the utility of Barbados as an intermediary for foreign investment in Cuba.

Background on foreign investment in Cuba

Foreign Investment since the 1995 Reforms

A problem for Cuba’s economy is the low level of investment in the country, which is only half the regional average. In June 2014, the Cuban government issued an update to its 1995 regulations governing foreign investment. The law expands the permissibility of foreign investment in all sectors, except health care, education and armed forces. The law exempts foreign investors from personal income tax, labour tax and taxes on select imports. The law also gives new investors a holiday of eight years before they have to pay the country’s tax on profits and a one-year holiday on sales tax obligations.¹

The new foreign investment law allows investors to open accounts in convertible currency in foreign banks and directly import and export. The law allows Cuban “legal persons”, to be investors. It allows the Cuban diaspora to invest but precludes investment by Cuban individuals, including the self-employed. The law is intended to attract investment in the Special Development Zone in the Port of Mariel (Zona Especial de Desarrollo Mariel).³

The law continues the requirement for foreign investors to apply to the government to hire Cuban workers. It requires companies to submit labour disputes to a state agency for resolution. Investors must pay salaries in hard currency to the Cuban government.

The law requires the government to make decisions on new investments within 60 days. It allows expropriation for reasons of public utility or social interest, but provides for compensation in the case of expropriation. In several cases, dispute resolution is left to local courts instead of the international court of arbitration.³

Critique of 2014 amendments to Foreign Investment Law

On 16 April 2014, Cuba’s new Foreign Investment Law was published in the Official Gazette. Its goal is to provide an improved legal, fiscal and regulatory framework for foreign enterprises operating in Cuba. The law provides greater security of tenure, greater control over the hiring and compensation of workers and generous tax breaks.

The prosecution of Tokmakjian and other foreign investors

One cautionary note for prospective foreign investors in Cuba has been the number of prosecutions of foreign investors, including Cy Tokmakjian, by Cuba.⁴

On 21 February 2015, Cuba released Cy Tokmakjian, a Canadian businessman who was imprisoned in Cuba on corruption and tax evasion charges for more than three years.⁵ Earlier in 2014, Cuba arrested Sarkis Yacoubian, another Canadian investor.
businessman and expelled him one year into a nine year sentence. Cuba arrested Tokmakjian in an anti-graft initiative that also targeted Cuban officials and foreign business executives from at least five countries. In September 2014, Tokmakjian was sentenced to 15 years in prison, along with his firm managers.

Before his arrest, Cuba had characterised him as a model business partner for over 20 years who had furnished critical transportation equipment when Cuba was undergoing a serious economic crisis after the collapse of the Soviet Union. Yet, Cuban prosecutors accused Tokmakjian of providing Cuban officials and their families with a series of gifts.

The prosecution annoyed Canada, a major trading partner. According to the Tokmakjian family, the prosecution was an excuse to seize the Tokmakjian Group’s USD100 million in assets in Cuba. The Tokmakjian Group itself has challenged the seizure of these company assets, including bank accounts, inventory and office supplies, in both arbitration before the International Chamber of Commerce and in an Ontario court.

The prosecution of Tokmakjian arose partly from salary top-up payments to Tokmakjian employees in joint venture businesses and hiring the wife of Cuba’s former deputy minister. In 2007, Cuba legalised the payment of incentives or salary top ups. However, the change did not extend to joint ventures, leaving companies exposed. Another allegation against Tokmakjian was that he conducted unauthorised financial transactions and illegally took large amounts of money out of the country.

Tokmakjian International Inc. was incorporated in Barbados in 2001 as an International Business Company (IBC), and had entered into various leasing contracts for equipment with different Cuban entities. Tokmakjian and the IBC allegedly committed tax evasion because they paid no taxes on the income generated by the transactions and commercial operations in Cuba.

During the trial the prosecutor argued that taxes should be paid because the IBC operated a “permanent establishment” with only one employee and no real or substantial activity in Barbados.

The Cuban prosecutor denied that the provisions of Article 5 of the Double Tax Agreement (DTA) between Cuba and Barbados applying, which provides for exceptions to the general rule for permanent establishments, and concluded that the “IBC” regime should not be respected because Barbados is a tax haven and the IBC is only an instrument to avoid taxes. In so doing, the prosecutor also ignored the provisions of Article 25(1) of the DTA, which require the competent authorities to try to resolve differences over taxation by mutual agreement.

The Cuban tax authority (Oficina Nacional de Administración Tributaria – ONAT) apparently applied the 35% tax rate for profits on gross sales with no deductions rather than the 4% tax on sales, which would have applied if Tokmakjian were deemed to have operated a permanent establishment in Cuba.

Current and prospective foreign investors are also considering other criminal cases brought in Cuba against foreign investors. In 2011, Cuba raided and closed Coral Capital, a partner in Havana’s Saratoga Hotel, as part of its anti-corruption initiative. Foreign executives of Coral Capital, were convicted and some of them deported. Stephen Purvis, a British architect and former head of development projects at Coral Capital, was initially accused of “revealing state secrets” and “illegal activities.” He was detained and charged with “economic crimes.” He did not see the specific charges against him and said his lawyer was never present during his interviews.

Notwithstanding the prosecution by Cuba of certain foreign investors, until now the biggest enforcement obstacle for foreign investors in Cuba has been US sanctions.

Analysis

While the lack of reliable statistical information published by the Cuban government makes it difficult to assess the impact of the country’s reform policies precisely, they have clearly failed to generate the economic growth Cuba needs. Since 2009, official growth targets have not been met, and economic growth has been among the lowest in the region. Cuba’s annual average growth rate of 1.7% from 2009 to 2014 suggests that the reforms have not helped to boost the country’s economy significantly.

Efforts to reduce public sector spending have had adverse social consequences. Reductions in health care services have in turn reduced access to social services. Removal of goods from rationing and their sale at much higher market prices, as well as increases in public utility tariffs and hard currency shops’ prices, have negatively affected consumption.

Efforts to trim redundant public sector employment have raised the unemployment rate from 1.6% to 3.4% of the labour force from 2007 to 2013. Simultaneously, real wages and real pensions have fallen by 73% and 50% respectively, from 1989 to 2013. Cuba is attempting to both restore productivity and dynamism to its moribund economy while limiting the power of market forces. Such reforms have brought about some positive developments, as well as certain setbacks and hardships. Further easing of US sanctions and the resultant likely increase in trade and investments may prove to be a welcome boost for the Cuban economy and its reform agenda.

Barbados as a conduit for investments in Cuba

Much of the potential advantage for foreign investors in Cuba using Barbados as a conduit for such investments results from the fact that Barbados has both a double tax agreement and a bilateral investment treaty with Cuba, and that the CARICOM and Cuba have a Trade and Economic Co-operation Agreement.

Double Tax Agreement with Cuba

As of 1 June 2011, Cuba had income tax treaties with Austria, Barbados, China, Portugal, Qatar, Russia, Spain, Venezuela, and Vietnam. The treaties with China, Portugal and Vietnam apply only to income while the others apply to both income and capital. Of these treaties, the one with Barbados is among those potentially useful for planning purposes.

The 1999 Barbados-Cuba income tax treaty (the DTA) applies to personal income tax and tax on profits in Cuba. Significantly, the DTA does not have treaty abuse provisions. It means that significant planning opportunities exist if foreign investors want to engage in tax planning through Barbados entities. However, the above-mentioned Tokmakjian case and the Cuban government’s general perspective on private investment and wealth accumulation means that foreign investors may have to somewhat discount the potential opportunities
presented by using Barbados entities.

Article 1(h)(ii) of the DTA (General Definitions) defines “national” in the case of Barbados as “any individual who is a citizen of Barbados, and any legal person, partnership and association deriving its status as such from the laws in force in Barbados.”

Article 4(1) states that the term resident of a treaty country means any person who under the laws of that country is liable to tax therein by reason of his/her domicile, residence, place of management or any other criterion of a similar nature. However, this term does not include any person who is liable to tax in that country in respect only of income from sources in that country.

The permanent establishment (PE) article is somewhat standard. It provides in Article 5(2) that a PE includes a place of management; a branch; an office; a factory; a workshop; and a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

Article 5(4) provides that a PE also includes the furnishing of services, including consultancy services, by an enterprise through employees or other personnel where activities of that nature continue (for the same or connected project) within the country for a period or periods aggregating more than six months within any 12-month period.

Under Article 5(6), notwithstanding the provisions of Articles 5(1) and (2), where a person, other than an agent of an independent status to whom paragraph 7 applies, is acting on behalf of an enterprise and has, and habitually exercises, in a treaty country (e.g., Cuba) an authority to conclude contracts in the name of the enterprise, that enterprise will be deemed to have a PE in that State (e.g., Cuba) in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in Article 5(5) which, if exercised through a fixed place of business, would not make this fixed place of business a PE under the provisions of that paragraph.

Article 7 (Business Profits) provides that the profits of an enterprise of a treaty country (e.g., Barbados) are taxable only in that State unless the enterprise carries on business in the other treaty country (e.g., Cuba) through a PE situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State (e.g., Cuba) but only so much of them as are attributable to that PE.

Article 8(1) (Transportation Income) provides that profits from the operation of ships or aircraft in international traffic will be taxable only in the treaty country in which the place of effective management of the enterprise is situated (e.g., Barbados).

Article 9 (Associated Enterprises) is standard. It provides in Article 9(1) that where an enterprise of a treaty country (e.g., Barbados) participates directly or indirectly in the management, control or capital of an enterprise of the other treaty country (e.g., Cuba), or the same persons participate directly or indirectly in the management, control or capital of an enterprise of a treaty country and an enterprise of the other treaty country (e.g., Cuba), and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

Article 10 (Dividends) provides that the host country (e.g., Cuba) can impose a tax on dividends not to exceed: (a) 5% of the gross amount of the dividends if the beneficial owner is a company which holds directly at least 25% of the capital of the company paying the dividends; or (b) 15% of the gross amount of the dividends in all other cases.

Article 11 (Interest) provides that the host country (e.g., Cuba) can impose a tax of not more than 10% of the gross amount of the interest if the recipient is the beneficial owner and is a resident of the other treaty country (e.g., Barbados).

Article 12 (Royalties) provides that the host country can tax royalties arising in the host country (e.g., Cuba) and paid to a resident of the other treaty country (e.g., Barbados) not to exceed 5% of the gross amount of the royalties.

Article 17(1) (Artists and Sportsmen) permits the host country(e.g., Cuba) to tax the income derived by a resident of a treaty country (e.g., Barbados) as an artiste, such as a theatre, motion picture, radio or television artiste, or a musician, or as a sportsman, from his personal activities as such exercised in the host country. However,Article 17(3) provides that income derived from activities performed in a treaty country (e.g., Barbados) by artistes or sportsmen if the visit to that treaty country is substantially supported by public funds of the other treaty country (e.g., Cuba) will be taxable only in that other country (e.g., Cuba). Since Cuba heavily subsidizes cultural and sports activities, and has a rich array of cultural performances, it is likely that artistes and sportsmen performing activities in Barbados will be supported by the Cuban government.

Article 23 (Relief from Taxation) provides that each country is obligated to eliminate double taxation.

Article 24 (Non-discrimination) precludes nationals of a treaty country (e.g., Barbados) from being subjected in the other treaty country (e.g., Cuba) to any taxation or any requirement connected therewith which is different from or more burdensome than the taxation and connected requirements to which nationals of that other treaty country (e.g., Cuba) in the same circumstances are or may be subjected.

Article 25(1) (Mutual Agreement Procedure) provides that when a person considers that the actions of one or both of the treaty countries result or will result for him in taxation not in accordance with the provisions of the treaty, he may, irrespective of the remedies provided by the domestic laws of those treaty countries (e.g., Cuba), present his case to the competent authorities of the treaty country of which he is a resident (e.g., Barbados), or if his case comes under Article 24(1), to that of the treaty country to which he is a national. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the DTA.

Article 25(2) requires the competent authorities to try, if the claim or part of it is not to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authorities of the other treaty country, with a view to the avoidance of taxation which is not in accordance with the DTA. Any agreement reached will be implemented notwithstanding any time limits in the domestic laws of the treaty countries.

Article 25(3) requires the competent authorities of the treaty countries to try to resolve by mutual agreement any difficulties or doubts.
arising as to the interpretation or application of the DTA.

Article 26 provides for standard exchange of information between the two countries.

The P&I and business profits articles, together with the comparatively low withholding taxes on dividends, interest, and royalties and the absence of treaty shopping/abuse provisions, on their face give Barbados significant opportunities for business planning for foreign investments in Cuba, provided Barbados can overcome and resolve the issues presented by the Tokmakjian case in which Cuba prosecuted as tax evasion apparent proactive tax avoidance transactions pursuant to the DTA.

**Bilateral Investment Treaty with Cuba**

Cuba has signed 60 bilateral investment agreements, and 40 of them remain in force.

On 19 February 1996, Barbados and Cuba concluded a bilateral investment treaty (BIT) which became effective on 13 August 1998.

Article I(a) of the BIT defines investment broadly to include every kind of asset such as (i) movable and immovable property and any other property rights, such as mortgages, liens or pledges; (ii) shares in and stock in undertakings in which Cuba and any other form of participation in a company; (ii) shares in and stock in undertakings in which Cuba and any other form of participation in a company; (ii) claims to money or to any performance under contract having a financial value; (iv) intellectual property rights, goodwill, technical processes and know-how; and (v) business concessions conferred by law or under contract, including concessions to search for, cultivate, extract or exploit natural resources.

Article I(d)(i) defines nationals in respect of Barbados as physical persons deriving their status as Barbados nationals from the laws in force in Barbados, and defines companies in respect of Barbados as companies, firms and associations incorporated or constituted under the laws in force in Barbados.

Article 2(2) requires investments of nationals or companies of each treaty country (e.g., Barbados) to be at all times accorded fair and equitable treatment and to enjoy full protection and security in the territory of the other treaty country (e.g., Cuba). Neither treaty country (e.g., Cuba) can in any way impair by unreasonable or discriminatory measures the management, maintenance, use, enjoyment or disposal of investments in its territory of nationals or companies of the other treaty country. Article 3(1) and 3(2) apply National Treatment and Most-Favoured-Nation Principles.

Under Article 4(1) (Compensation for Losses) nationals or companies of one treaty country (e.g., Barbados) whose investments in the territory of the other treaty country (e.g., Cuba) suffer losses owing to war, other armed conflict, revolution, a state of national emergency, revolt, insurrection or riot in the territory of the latter treaty country (e.g., Cuba) must be accorded by the latter treaty country treatment, as regards restitution, indemnification, compensation or other settlement, no less favourable than that to which the latter treaty country accords to its own nationals or companies or to nationals or companies of any third state.

Article 5(1) (Expropriation) requires that investments of nationals or companies of either treaty country (e.g., Barbados) must not be nationalised, expropriated or subjected to measures having effect equivalent to nationalisation or expropriation in the territory of the other treaty country (e.g., Cuba), except for a public purpose related to the internal needs of that treaty country on a non-discriminatory basis and subject to prompt, adequate and effective compensation. Such compensation must amount to the real value of the investment expropriated immediately before the expropriation. The national or company affected must have a right, under the laws of the treaty country making the expropriation (e.g., Cuba), to prompt review by a judicial or other independent authority of that treaty country.

Article 6 (Repatriation of Investment and Returns) requires each treaty country (e.g., Cuba) in respect of investments of nationals or companies of the other treaty country (e.g., Barbados) to allow the unrestricted transfer of their investments and returns after the payment of any taxes in the territory of the host country in respect of the investment. Transfers must be effected without delay in the convertible currency in which the capital was originally invested or in any other convertible currency agreed by the investor and the treaty country concerned.

Article 8(1) (Settlement of Disputes Between an Investor and a Host State) requires that disputes between a national or company of one treaty country (e.g., Barbados) and the other treaty country (e.g., Cuba) concerning an obligation of the latter under the BIT in relation to an investment of the former which has not been amicably settled must, after a period of three months from written notification of a claim, be submitted to international arbitration if the national or company concerned so wishes, through the Court of Arbitration of the International Chamber of Commerce; or an international arbitrator or ad hoc arbitration tribunal to be appointed by a special agreement or established under the Arbitration Rules of the United Nations Commission in International Trade Laws as then in force.

Article 9 concerns disputes between the treaty countries. Article 10 allows one treaty country (e.g., Barbados) making a payment under an indemnity obligation against a non-commercial risk given in respect of an investment in the territory of the other treaty country (e.g., Cuba) to have the other treaty country recognise the assignment to the first treaty country (e.g., Barbados) by law or by legal transaction of all the rights and claims of the party indemnified, and the first treaty country (e.g., Barbados) to exercise such rights and enforce such claims by virtue of subrogation, to the same extent as the party indemnified.

Article 11 (Application of other Rules) provides that if the laws of either treaty country or obligations under international law existing at present or established after the conclusion of the treaty between the treaty countries in addition to the present Agreement contain rules, whether general or specific, entitling investments by nationals or companies of the other treaty country to a treatment more favorable than is provided for by the present Agreement, such rules will to the extent that they are more favorable prevail over the present Agreement.

The Barbados-Cuba BIT clearly encompasses Barbados companies, including IBCs, SRLs, and other entities benefiting from international financial service provisions. It clearly encompasses a wide variety of investments. Under the BIT, Barbados nationals and entities have a right to national treatment, most-favoured nation treatment, “fair and equitable treatment,” and the application of other rules that may be more favorable. The BIT has no provisions concerning limitation on
benefits or treaty abuse. Finally, under the BIT, the purposes for which a country can expropriate an investment is rather limited and even then, the investor must be afforded “prompt, adequate and effective compensation.”

CARICOM and Cuba Trade and Economic Co-operation Agreement

In 2000, Cuba and a number of Caribbean countries, including Barbados, entered into the CARICOM-Cuba Trade and Economic Co-operation Agreement (the CARICOM-Cuba ETCA). The objectives of this Agreement are stated under Article 2 to be strengthening the commercial and economic relations between the signatory countries through (i) promoting and expanding trade in goods and services by means of, inter alia, free access to their markets and elimination of non-tariff barriers to trade, (ii) the establishment of financial arrangements to facilitate progressive development of two way trade, (iii) providing facilities for establishing and operating joint ventures and other forms of economic cooperation activities, (iv) developing mechanisms that promote and protect the investments made by their nationals, and (v) discouraging anti-competitive business practices.

Article 10 provides for promoting mutual economic and social co-operation in support of each country’s economic and social development and their economic integration. Under Article 12, the parties agreed to establish trade promotion programmes. Article 15 underscores the importance of trade in services for economic development and contemplates the establishment of a regime for such trade between the signatory countries, in particular with respect to tourism and travel-related services, financial services, construction and engineering services, computer and telecommunication services and transport services, all sectors in which Cuba needs to develop its economy. Under Article 15(3), each country is required to accord services and service suppliers of other countries with treatment no less favourable than that accorded to like services and service suppliers of its own country.

Article 16 concerns tourism and provides for (i) the preparation and promotion of tourism products and programmes designed to encourage multi-destination travel and to diversify and develop the tourism product in their countries, (ii) cooperation in the area of passenger transport, (iii) undertaking cultural exchanges and the exchange of entertainers on a commercial basis, and (iv) encouraging business participation in their tourism and entertainment sectors.

Conclusion

The potential investors who may want to access Cuba from Barbados will include, especially in the near term, hotels and other businesses engaged in tourism and related activities, including transportation, as well as enterprises involved in telecommunications, building and construction, financial services, and agriculture. These activities are also all liberalised under the revised US sanctions.

As the economic liberalisation in Cuba continues, the traditional investors, including Canadians, Europeans, and Latin Americans, are likely to deepen their own investments as the income of Cuban people increases and as more non-Cubans start spending time in Cuba for second homes and extended visits.

However, given the comparatively low levels of Cuban income, the market for Cuban purchasers of services and products will increase rather slowly. The entry of US banks and credit cards as well as the increased amounts of remittances by the Cuban diaspora and the increased activities of Americans in Cuba is bound to have some multiplier effect.

The ceiling will depend on the Cuban government’s attitude, policies, and laws with respect to the Cuban economy and foreign investment as well as wealth accumulation.

END NOTES:
2. Id.
3. Id.
4. Id.
5. This section is taken from Bruce Zagaris, Cuba Rescues Canadian After 3 Years in Jail for Corruption and Tax Crimes, 31 Int’l Enforcement L. Rep. 101 (Mar. 2015).
9. Id.
10. Id.
15. Mesa-Largo, supra, at 89.
16. Id.
17. Id.
18. Id.
19. For a list of Cuban DTAs, see the list from the Cuban Ministry of Finance http://www.mofp.cu/html_mofp/m_legislacion.php (accessed June 17, 2016).
22. For a discussion of the use of BITs to resolve tax disputes between the investor and host state, see Bruce Zagaris, Ecuador US Turn to Alternative Remedies in Tax Disputes, Tax Notes Int’l 705 (Nov. 22, 2004).